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***Privatization Issues  
for USAID  
Decision Makers***

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*Privatization is not simply a way to spur growth,  
but an opportunity to teach about market  
capitalism, to build institutions, and to reinforce  
democracy.... Properly done, it is a device of  
nation-building, of conflict resolution, and  
democratic education.*

J. Brian Atwood  
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## **TABLE OF CONTENTS**

### **Executive Summary**

<b>Introduction.....</b>	<b>1</b>
--------------------------	----------

### **Chapter I**

<b>Implementing Privatization.....</b>	<b>6</b>
When to Privatize?	
Implementing Privatization	
What Are the Risks?	
Conclusion	

### **Chapter II**

<b>USAID's Programs.....</b>	<b>18</b>
USAID's Programs	
Benefits of USAID's Program	
What Does USAID Do Best?	
Donor Collaboration	
Conclusion	

### **Chapter III**

<b>Privatization's Linkage to</b>	
<b>USAID's Strategies.....</b>	<b>27</b>
Democracy	
Preventative Health Care and Social Services	
The Environment	
Non-Governmental Organizations	
Conclusion	

### **Chapter IV**

<b>Conclusion: Privatization's</b>	
<b>Challenge.....</b>	<b>38</b>
Regional Issues	
Targets of Opportunity	
Conclusion	

### **Annexes**

<b>Annex A - Impact of the Honduras Privatization Program</b>	
<b>Annex B - List of Key Informants Interviewed</b>	
<b>Annex C - List of References</b>	

## **EXECUTIVE SUMMARY**

When and whether to privatize are basic questions for all decision makers and have been topics of much discussion by practitioners and academics. Critical decision points include:

- Is a country ready or capable of considering a private sector oriented growth strategy?
- Does privatization advance a country's development priorities?
- Does the political will exist to implement privatization?
- What are the basic limitations or hurdles that privatization will face during implementation and how can these be addressed?

Privatization objectives must be clearly defined, simple, and straightforward. Too often, governments look to privatization as a panacea to their economic woes as they seek to increase revenue generation, augment ownership dispersion, develop local capital markets, and improve public and private sector efficiency. Properly designed and implemented, privatization can *contribute* to the achievement of these objectives, but it is unwise to rely on exclusively on this strategy to accomplish them. To be sustainable, privatization's objectives should be part of a broader social and economic agenda.

There is a range of risks with implementing any privatization agenda. These encompass issues of labor displacement, ownership concentration (monopolies and ethnic bias), consumer prices, political instability, and environmental hazards. In different contexts, all of these areas have potential and need to be assessed and addressed before implementation commences. However, even a properly designed and implemented privatization program will have unexpected repercussions. These risks should be approached with flexibility and innovation.

USAID's formal policy on privatization was announced in February 1986. The rationale for this strategy was based on the tenet that privatization was a vital component of economic development. In terms of sustainable development, privatization was seen as a mechanism that allowed governments to reduce their debt burden and increase service delivery<sup>1</sup>, support the expansion of local private sector led growth, and provide a catalyst for more open and competitive market economies.

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<sup>1</sup> The sale of State Owned Enterprises (SOEs) can financially support the provision of public services such as health care, education, transportation. In the late 1980s, countries such as Bolivia sacrificed their public services when SOE losses accounted for more than two-thirds of the government's overall budget deficit.

USAID has played various roles in supporting privatization around the world. Programs have emphasized an informational approach, and included technical assistance and financial support.

A well planned privatization program can achieve only as much as country conditions permit. A strongly supported government-donor privatization program can vary in its success accordingly: a good plan + a weak economy = no change; a good plan + a strong economy + bureaucratic resistance and ineptitude = no change. In the end, a successful privatization effort may be more directly linked to the capacity and orientation of a government's bureaucracy than to donor assistance. Consequently, privatization is likely to be more difficult in least developed countries.

Key informants interviewed for this report expressed a wide range of ideas on USAID's institutional forte:

- USAID can provide "models" of successful privatization strategies and approaches.
- USAID's institutional knowledge and experience on privatization facilitates cross-regional learning.
- USAID's in-country presence in developing countries gives it greater visibility and influence with host country government officials.
- USAID has contracting vehicles (such as IQCs - Indefinite Quantity Contracts - and work-orders) that can allow quick and responsive actions.
- USAID has the capacity to identify and provide specialized technical assistance in areas such as finance, accounting, legal property rights, and management.

There is little written evidence on donor collaboration efforts in privatization projects. Explanations by respondents for the lack of donor collaboration centered around donors' competing agendas. Competing agendas are a reflection of the different funding approaches and ideologies that make it extremely difficult to develop common or complementary country strategies. For example, USAID's inability to co-mingle its funds with those of other donors has limited its ability to integrate its approach and funding resources with a large-scale multi-donor effort in Egypt.

Other factors that limit donor collaboration noted by informants include differences in:

- The priorities and resource levels donors have allocated to a country;
- Donors' interests in working on a particular project; and
- Donors' abilities to maintain staff to work on project design and implementation on a medium- to long-term basis.

Privatization can positively contribute to building civil societies and strengthening democratic systems, improving the effective delivery of basic services, and developing appropriate environmental policies. An assessment of a country's development needs is critical to determine whether or not there is an appropriate role for privatization.

Privatization is thus a process and not an end in itself which can be used in conjunction with a variety of other mechanisms to achieve cross sectoral objectives. When integrated strategically with other priority areas, privatization can advance sustainable development goals.

## **INTRODUCTION**

### ***Privatization Issues for USAID Decision Makers***

As USAID struggles to assess and prioritize its objectives, privatization is being evaluated on its costs and benefits, and its support to the Agency's broader sustainability goals. This study attempts to shed new light on how privatization can support USAID's initiatives of democracy and governance, environment and natural resources, and health and family planning. It also provides some practical guidance on implementing privatization programs as well as potential political, economic, and social risks.

Built on the premise that locally supported and appropriately designed privatization programs can bolster sustainable development, the last section of the paper addresses key issues for USAID's long-term privatization strategy.

This study is based on over forty key informant interviews with USAID staff in Washington and the field, World Bank officials, and contractors as well as document review and analysis of academic, World Bank, and USAID studies and reports.<sup>2</sup> It does not discuss technical aspects of privatization but raises key questions that should be addressed by decision makers contemplating a privatization endeavor.

Pivotal decision points presented in this analysis include:

- What are the factors that should be appraised by decision makers when considering a privatization program?
- How can USAID assess the impact of its privatization programs?
- What is USAID's institutional forte regarding privatization and has it used this strength in implementing its programs?
- How can USAID improve its collaboration with other donors in privatization programs?
- How does privatization support USAID's new strategic initiatives?
- What should be USAID's long-term privatization strategy?

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<sup>2</sup> Key informants were selected based on: (1) years involved in designing, implementing, and evaluating privatization programs; (2) knowledge of USAID privatization activities; (3) experience with non USAID-funded privatization programs (the EEC's PHARE program, the British Know How Fund, CIDA, and the GTZ).

Together, these interview results and studies present a comprehensive picture of USAID's privatization activities and indicate directions for further discussion and analysis for policy makers and practitioners.

The remainder of this introduction gives a working definition of privatization, a short historical perspective on privatization, and some background to USAID's privatization efforts.

### ***What is Privatization?***

Privatization's definition can vary depending on the context. Generally speaking, privatization means the sale or transfer of an activity from the public to the private sector. A change in ownership is often, but not always, involved.

The privatization approach taken by a government should reflect its social, political, and economic traditions and needs. It is therefore difficult to generalize or compare privatization efforts across countries or regions. For example, privatization in Russia is taking place in an environment with extremely limited exposure to free market principles, a very small private sector, lack of capital markets, and meager business and investment skills. In addition, Russia must deal with problems regarding its evolving political institutions, basic social issues, and lack of public acceptance to and political will for privatization.

The nature of Russia's privatization endeavors is very different from programs in countries such as the United Kingdom, Jamaica, or the Philippines. In these countries, most economic activity already takes place in the private sector. They are therefore more likely to have public receptivity to the concepts of privatization, local investors, and political support for privatization.

Different privatization approaches also make cross sector comparisons difficult. Broadly speaking, there are four major types of institutions that can be transferred from the public to the private sector:

- Large and small productive enterprises;
- Public utilities and other "natural monopolies";
- Bodies that are largely regulatory, such as marketing boards; and
- Management or operation of activities (health posts, schools, waste disposal) where the funding and control remains in the public sector.

Privatizing these institutions requires different processes and strategies. For productive enterprises, the emphasis is on the terms of sale and assuring that the enterprise is salable and the sales process is open and fair. The second type of institution, public utilities, requires some type of post-sale regulatory framework to control the monopoly power of enterprises. The third type often requires no sale, but requires a regulatory reform that eliminates the monopoly of the regulatory body over activities. The fourth type of institution usually does not involve a direct sale of assets but does require the government to manage a contractor, thus involving a certain level of government effectiveness.



The specific mix of such institutions varies widely among countries. In Eastern Europe, virtually everything was in government hands in the recent past; in Asia and Africa, large firms and regulatory bodies in the public sector have coexisted with the private operation of small and medium businesses; in Latin America, most of the productive enterprises, large and small, have usually been in the private sector. These country conditions are important to thinking about privatization. In Eastern Europe, privatization is essential. In the second group, it is important to promoting sustainable growth. And in the third, it may be desirable for achieving narrower sectoral objectives, but is probably of limited value in overall development terms.

It is important to keep these differences in mind during the subsequent discussion of USAID's privatization agenda. The broadest application of privatization will be used in this study -- the transfer or sale of an asset from the public to the private sector -- but the levels and types of privatization must be kept in mind when drawing conclusions and lessons learned.

### ***Privatization: Past, Present, & Future***

The world has experienced a wave of privatization activity in the 1980s and early 1990s. This has constituted a significant reversal of the nationalization and socialization trends that emerged in many countries since the Russian Revolution. These trends in themselves were responses to the very narrow control over resources found in many agrarian, pre-industrial, and early industrial societies.

The recent surge in privatization is in response to the belief that government-managed assets typically do not work as efficiently or effectively as privately owned and operated establishments. As a result, many industrialized and developing country governments began selling off state assets to the private sector. Some governments have been selective and have sold a few strategic holdings. Others, as in Eastern Europe, are selling off entire sectors of government properties.

Even the most well prepared and aggressive privatization strategies have experienced unexpected hurdles and problems. In many instances, the World Bank and other donors forced privatization upon host country governments that were inexperienced and ill-equipped to deal with the issues privatization raised. This experience has raised a number of questions: When does privatization work? What should be in place before privatization is considered? What economic and social repercussions should be expected?

One overall conclusion emerges: that privatization is not a panacea to developing country problems and must be recognized for its strengths and weaknesses; when it can work and when it can't; how it can solve host country problems and when it can make them worse. These questions, nevertheless, have not always been considered when devising new privatization strategies.

As resources and donor emphases shift, privatization's capacity to support these new efforts deserves attention. This single tool, if designed appropriately, can help governments meet a range of development priorities. However, it must also be acknowledged as a development *tool* not a development goal -- that can facilitate increased productivity, efficiency, and in the right circumstances, equity. Its uses will vary widely and should always reflect a country's economic, social, and political conditions.

The lesson for future policymakers is to gain a better understanding of privatization's flexibility and range of approaches. Its political nature along with financial complexities may make privatization untenable for some developing countries. For others countries, privatization may be a useful tool to supplement a government's overall development strategy.

### ***USAID's Privatization Program***

Originally mandated as an objective of the Agency in 1986, privatization was conceived as an important development strategy. Today, privatization is seen as a mechanism that can reduce government debt burdens, increase efficient service delivery, provide a catalyst for more open and competitive market economies, and encourage innovation.<sup>3</sup>

In the 1980s, USAID's privatization projects focused on funding technical assistance in strategy formulation, valuation, legal and financial systems, regulatory institutions, public awareness, marketing, feasibility studies, negotiating strategies, and institutional strengthening. Many programs also maintained a sectoral emphasis such as the privatization of agricultural systems and parastatals in Africa.

In the 1990s, USAID has continued its privatization endeavors. Although Eastern Europe and the former Soviet Union have captured a great deal of attention, other programs are quietly taking place around the world. Even in Africa, where weak financial markets, huge government debts, lack of political will, and few local investors exist, privatization efforts continue. Other regions, such as Asia, the Middle East, and Latin America, are also implementing privatization programs of all kinds including complete divestitures, employee stock ownership plans, and contracting out.

USAID's privatization programs are directly linked to its much larger private sector development portfolio. In some cases, their overlapping goals and objectives make it difficult to separate one from the other. This trend may increase in the future as USAID Missions explore mechanisms to encourage private sector participation in many traditional governmental areas, such as the delivery of public goods or providing basic infrastructure.

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<sup>3</sup> USAID. *Implementing A.I.D. Privatization Objectives*. Policy Determination-14. Washington, D.C.: USAID, 1991. p. 1.

**In general, USAID's privatization projects are often one part of a larger privatization effort coordinated by the World Bank or other donors. USAID's privatization activities have often been implemented in settings where the Bank has linked a nation's privatization with a structural adjustment program (SAP).**

**USAID policymakers need to continue to find new and innovative ways to incorporate privatization ventures into a broader agenda that supports lasting public-private partnerships.**

# **CHAPTER I**

## **IMPLEMENTING PRIVATIZATION**

### **WHEN (AND IF) TO PRIVATIZE?**

When and whether to privatize are basic questions for all decision makers and have been topics of much discussion by practitioners and academics. Critical decision points from the literature include:

- Is the macroeconomic policy environment conducive to privatization?
- Do financial market systems and institutions have the capacity to support a privatization campaign?
- Are the appropriate regulatory institutions in place to protect the economy and the environment?
- Do the existing laws need to be revised to provide the necessary protection and regulation of the private sector?
- What has been the private sector's historical participation in the economy?
- Is there significant labor union (or any influential group) opposition to privatization?
- Does the political will exist to move a privatization agenda forward?<sup>4</sup>

Below is a brief discussion of the issues raised above and how USAID decision makers may choose to address them when considering a privatization initiative.

#### ***Macroeconomic Policy Environment***

Much of the research on privatization indicates that a growing economy coupled with an enabling policy environment are necessary prerequisites to privatization -- or at the least, reform in these areas should be part of a privatization program. Mexico and Chile are often referenced as

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<sup>4</sup> Many of these points are addressed in existing reports and studies. (See: *Privatization: The Lessons of Experience*, by Mary Shirley (1992); *Financing Privatization Under Limited Capital Conditions*, by Ron Ivey and Jorge Segarra (1988); and *Steve Hanke's Privatization and Development*, by Steve Hanke (1986), among many others.)

successful examples of countries that implemented essential macroeconomic reforms well before privatization took place.

This general rule is often followed by USAID Missions as they attempt to link economic reform issues to privatization targets through the use of non-project assistance, PL 480, local currency generation, and other resources. In many cases, however, the World Bank is the major player in a country's economic reform program and their agenda should set the tone for other donor activities.

When considering a privatization program in a poorly functioning macroeconomic environment, decision makers should: (1) carefully construct a privatization program that dovetails with World Bank and other donor efforts; (2) develop good communications channels with all donors working in economic reform and privatization; and (3) consider targeted economic reform, i.e., working to achieve economic reform at the sector level that is closely linked to the privatization program.

### ***Weak Financial Markets***

In addition to the macroeconomic environment, other country conditions bear on the likelihood of a successful privatization effort. For example, privatization can take place in situations where only weak financial systems exist; however, these conditions must shape the approach taken.

Policymakers considering privatization where capital markets are distorted or not well developed should consider: (1) limiting stock market sales; (2) restricting complex financial transactions (such as debt-equity swaps); (3) developing plans to include the local private sector's investment and participation in the privatization program; and (4) using innovative financial mechanisms that are simple and/or encourage local investment and ownership diversification (such as employee stock ownership plans).

### ***Regulatory and Legal Systems***

The capacity of local regulatory and legal bodies to oversee a privatization initiative is critical. Issues that may need to be addressed include the need for new business or tax laws, strengthened regulatory bodies, foreign exchange controls, intellectual property protection, international dispute resolution, and labor laws.

Policymakers undertaking a privatization program in a country with weak regulatory institutions should: (1) incorporate resources for strengthening capacity; (2) consider the phased implementation of privatization to compensate for existing regulatory conditions; (3) incorporate appropriate regulatory measures into privatization transactions; and (4) link common needs to both the privatization agenda and the development of appropriate regulatory institutions.

On the legal systems side, business laws that both protect and oversee private sector activity must be considered at the country level. Decision makers should consider some of the following

before a privatization program takes place: (1) the government's legal authority to sell state-owned property; (2) the need for new laws pertaining to property rights and business laws (contract laws, company laws, bankruptcy laws, competition and trade laws, and so on.) and government ownership issues; (3) legal protection from monopoly formation; (4) revising business-related rules and regulations; and (5) creating appropriate legal and tax incentives regarding trade, investment, and environmental protection.

### ***Private Sector History***

A country's history and traditions regarding private sector participation in the economy are also critical. Issues concerning the level and longevity of competition and basic market oriented principles must be assessed. For example, if a country has no recent history of competitive private sector behavior (such as the former Soviet Union) then the privatization strategy must reflect this tradition.<sup>5</sup>

Countries with no recent history of large-scale private sector involvement in the economy should consider some of the following before initiating a broad privatization program: (1) assess the local private sector's capacity for, and interest in, playing a role in the economy; (2) develop financial incentives to incorporate private sector participation in privatization; (3) inject substantial resources into education and awareness programs; (4) calculate potential repercussions to large-scale privatization; and (5) support the strengthening of private sector organizations, such as business associations and chambers of commerce.

### ***Labor Union Support***

Labor union support or opposition to privatization can be a critical element to a successful privatization effort. This fact is well discussed in the literature, such as USAID's report on labor and politics:

Opposition to privatization by labor unions' rank and file membership is a major deterrent to more rapid progress in privatization.<sup>6</sup>

Countries that have significant labor opposition to privatization or are attempting to privatize enterprises that will require labor displacement must evaluate the reasons behind this opposition (lack of understanding, fear, misperceptions, mistrust) and address them individually. Program initiatives should consider: (1) the development of appropriate labor compensation programs -- such as pension schemes, employee stock ownership, and early retirement packages; (2) the

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<sup>5</sup> Experience from the former Soviet Union has shown that building and strengthening the institutions of private property rights and contract enforcement is extremely important.

<sup>6</sup> USAID. *Critical Issues in Privatization: Politics, Institutions, and Labor*. Washington, D.C.: USAID, 1989.

formation of education and awareness programs directed at labor; (3) the creation of skills training programs that can adequately address labor's concerns regarding displacement; and (4) the creation of good communication channels with the labor community and its leaders.

### ***Political Will***

In many ways, political will to privatize can be considered the most important element in deciding *when to privatize*. Political will has been addressed in the literature and by practitioners as a critical prerequisite to privatization.

All key informants interviewed for this study agreed that privatization is a political process: that a successful privatization program could not take place without the political commitment of the government. The World Bank, USAID, and academic experts agree, articulating that political commitment is critical. In countries where it does not exist privatization will be less successful. An excerpt of lessons learned from an Africa Bureau overview on its private sector development activities supports this view:

The decision to embark on a privatization program is in the first instance political, regardless of the economic and financial pressures that may have promoted consideration of it. Virtually every facet of the privatizing process has its political overtones, ranging from deciding what to privatize, determining how to privatize it, choosing the buyer and, in some cases, finding financing for the deal. No amount of strategic planning or technical assistance will help a program work unless there is full, consistent and continuing commitment to privatization at the highest levels of government.<sup>7</sup>

Box I-A presents a similar appraisal from USAID/Guatemala.

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<sup>7</sup>Wortman, Miles. *Africa Private Sector Development*. Labat Anderson, Inc. Washington, D.C.: USAID, 1992. p.39.

**Box I-A  
A Guatemalan Experience**

From Guatemala, one Program Officer characterized her situation as follows:

In my country, there is great private sector interest in privatization of the few remaining public services. However, without political will and commitment on the part of the government for privatization, nothing will happen. Over the past six years, we have been involved in varying degrees in analyzing options for privatization; when the government has not been interested - all of the work that was done has wound up on a shelf.

When the government has made an official commitment to supporting privatization (as they have done now), we have had much more success in moving beyond just doing studies and have dedicated more of our resources to supporting these activities.

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USAID's experience in Eastern Europe also indicates that impact stems more from political considerations than technical or implementation matters.

Privatization is an intensely political process requiring top down commitment at the highest political levels. Failure can rarely be attributed predominately to technical reasons. Czechoslovakia, as an example, has been able to maintain the momentum of this privatization because of political leadership and support at the highest levels. In contrast, the Polish Ministry of Privatization has been stalled by the political fragmentation that, until recently, halted parliamentary approval of the program.<sup>8</sup>

These statements make a compelling argument for USAID to forego privatization efforts in countries that lack the political will to implement these programs. Although other elements may be equally important -- such as financial markets and macro-economic reforms -- getting the commitment of a country's political leaders to the process is a critical first step.

**Criteria for Determining Political Will**

One problem often mentioned by USAID project officers is the difficulty in determining whether the political will to privatize exists. They point to the fact that although some Heads of State may publicly expound the benefits of privatization, they may not have the bureaucratic or legislative support to implement a program.

If political will is the primary prerequisite to privatization, then a set of measures to assist practitioners would be useful. An example of several criteria decision makers may want to

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<sup>8</sup> *Privatization Phase I Program Evaluation: Early Experiences of Privatization in Hungary, Poland, and the Czech and Slovak Republics*. Prepared by Price Waterhouse. Washington, D.C.; USAID, 1993. p. 120.



consider before undertaking a privatization effort include:

- The degree of commitment to the principles of competition and free markets throughout all levels of government.
- The potential for bureaucratic resistance to privatization.
- The degree the host country is committed to using its own resources to ensure a successful privatization program, including: (1) revising existing laws; (2) supporting the strengthening of regulatory institutions; (3) compliance with an economic reform program; and (4) strengthening existing financial systems.
- The degree of hostility or caution noted by influential groups such as academics, bureaucrats, labor leaders, religious groups, the military, the legislature, or the media.
- Statements by political leaders in support or against privatization. Are there contradictory messages coming from within the government?
- The level of the World Bank's involvement in the country's structural adjustment program. Does the program have a privatization component and how successful has this been?

#### A Model?

Before initiating a full blown privatization program, which could require millions of dollars, USAID decision makers need to make strategic decisions regarding the viability of country conditions. In addition to making the assessments noted above, USAID may want to act in a more limited, cautious fashion until the political will can be "tested."

A simple model could involve initially taking on only simple, short-term pilot programs. (Pilot programs would only be funded after preliminary research had been carried out on the political will, history, and capacity of a country to implement a privatization effort.) The pilot effort could fund one person for one year and provide limited technical assistance to help in the sale of one or several small to medium-sized SOEs. At the end of one year, if no assets had been sold, the project could be terminated. If significant progress had been made then additional, limited, funding could be given.

#### Lack of Political Will

When the political will does not exist, aggressive privatization efforts are fruitless. Nonetheless, under these conditions USAID can provide limited support in precursor or pre-privatization efforts. These may include: (1) developing a public education campaign about the advantages

and disadvantages of privatization<sup>9</sup>; (2) supplying information on different models and approaches to privatization that can be more politically palatable (such as voucher schemes, contracting out, or employees' stock ownership plans); (3) supporting the privatization of one or more "pilot" activities; (4) promoting private sector competition to the public sector holdings; and (5) intensifying policy dialogue efforts.<sup>10</sup>

By pursuing one or more of these options, USAID could play a supporting role in regions such as Africa and the Middle East where there has been limited support for privatization. Regardless, without the political will and mandate for a greater private sector role in an economy, the Agency must carefully consider its ability to successfully implement a privatization program.

## **IMPLEMENTING PRIVATIZATION**

### ***Defining Objectives***

Privatization objectives must be clearly defined, simple, and straightforward. Too often, governments look to privatization as a panacea for their economic woes as they seek to increase revenue generation, augment ownership dispersion, develop local capital markets, and improve public and private sector efficiency. Properly designed and implemented, privatization can *contribute* to achieving these objectives but it is unwise to rely on exclusively on this strategy to accomplish them. To be sustainable, privatization's objectives should be part of a broader social and economic agenda.

The World Bank advocates that governments define their privatization objectives in terms of increasing efficiency, which they feel will result in a significant impact on a country's economic welfare. In many cases, multilateral and bilateral donors mandate similar targets, goals, and/or objectives for privatization.

A more realistic approach may be to define privatization's objectives through country conditions and needs -- as identified by national governments and other affected stakeholders. For example, in Latin America governments may use privatization to help lift their economies out of stagnation and hyperinflation and to reduce their external debts. Southeast Asian countries - - such as Indonesia, Malaysia, and Thailand -- may look to privatization to reduce the fiscal

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<sup>9</sup> USAID has supported two successful public education campaigns in Sri Lanka and Tunisia to inform the general public about the government's on-going privatization programs.

<sup>10</sup> USAID. *Implementing A.I.D. Privatization Objectives*. PD-14. Washington, D.C.: USAID, 1991. p. 3.

burden created by SOEs and to encourage private sector investment in economic infrastructure.<sup>11</sup> If privatization is to achieve sustainable benefits, its objectives must be a reflection of country conditions.

The objective to "privatize" may also not be the top priority of a government -- or it may shift according to local conditions. World wide economic recession, inflation, or elections can affect a government's privatization strategy. These factors make it necessary for policymakers to support objectives that are not only well defined but also flexible.

### ***How Much, How Fast?***

Experience indicates that privatizing small assets first, learning and problem solving during this period, and later attempting the sale of larger, more complex holdings may be best. Chile, Poland, the Philippines, and Togo all took this as their model, initiating a privatization campaign with small and medium-sized firms in competitive sectors.

Smaller entities often have the simplest assets to sell and therefore the process can be relatively quick. For example, privatization of smaller enterprises rarely calls for restructuring, entails minimal political risk, and can often be absorbed by the local investment community.

Brazil and Argentina offer another approach of initially privatizing larger SOEs, such as utilities. These sales are often more complex because they involve: (1) developing a competitive environment and regulatory framework; (2) the need for fairly sophisticated financial institutions; and (3) dealing with potentially large numbers of displaced labor.<sup>12</sup>

The benefits of privatizing large scale enterprises can be substantial if the program works well by sending strong signals to local and foreign investors of the government's commitment to privatization, and the potential financial and economic benefits. For example, privatizing assets such as power and telecommunications can help provide cheaper and more efficient services that are critical for an economy's growth and development. Due to the highly visible nature of these undertakings, their failure can also discount future privatization opportunities.

How much and how fast to privatize must be determined by country conditions and government objectives. If a country wants to address its debt burden problems, it will eventually need to consider privatizing its larger SOEs. The program can be carried out gradually by looking first at restructuring options, contracting out management, partial divestiture, or employee stock ownership plans. All of these alternatives can be investigated to determine their potential and implications for society and the economy.

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<sup>11</sup> Viravan, Amnuay. *Privatization: Financial Choices and Opportunities*. San Francisco, CA: International Center for Economic Growth, 1992. p. 10.

<sup>12</sup> Shirley, Mary. *Privatization: The Lessons of Experience*. Washington, D.C.: World Bank, 1992. p. 25.

On the other hand, if a government's objectives are to spur private sector growth it may consider selling off small scale SOEs that are affordable to the local business community. The speed of this approach will be defined by the limitations imposed by country conditions such as local investment capacity, local skill availability, and country economic conditions.

There is no easy formula to calculate how much or how fast to privatize. There are trade-offs involved in every choice that must be carefully considered by decision makers before privatization is implemented.

## **WHAT ARE THE RISKS?**

### ***Labor Displacement***

The level of labor displacement from privatization depends on the sectors and the types of SOEs targeted for sale. The privatization of smaller assets is less likely to have significant labor repercussions. The fact that the sale of larger SOEs will often lead to layoffs and labor displacement has led many governments to limit privatization to more modest holdings.

The realities of labor displacement are often overshadowed by political and societal beliefs that there will be a significant labor impact from privatization. Whether these perceptions are founded in reality is irrelevant if they reflect a fundamental mistrust in the process. To overcome these hurdles, governments must examine society's needs, issues, and fears regarding labor displacement and build appropriate responses into their privatization programs.

Privatization programs must address the labor issue at the initial stages of its implementation. Targeted education campaigns must be devised and programs must be developed to overcome the displacement issue through training programs, pension schemes, job counseling, or early retirement packages. In some cases, as in Jamaica, the offer of preferential access to stock in the privatized companies may attract strong labor support.

### ***Ownership Concentration***

Ownership distribution or concentration is another risk associated with privatization. A real concern exists that the sale of government enterprises can result in a concentration of ownership by elites. As stipulated in the 1992 World Bank report on lessons learned in privatization:

Experience shows that share ownership tends to concentrate over time, despite the mechanisms used to attract and retain small shareholders. Examples of this phenomena include the United Kingdom, Malaysia, Jamaica, Chile, and France (and some preliminary indications from Russia's initial attempts at ownership diversification).<sup>13</sup>

Privatization programs in Eastern Europe and Former Soviet Union have initiated aggressive strategies to diversify ownership through voucher schemes, employee stock ownership, and mass privatization techniques. Although it is still too soon to be evaluated, many key informants questioned whether this would have a positive long-term impact.

**Box I-B  
Ethnic Bias**

The concentration of ownership can be a concern in many different settings. In African countries, such as in Tanzania and Zambia, the problem of ethnicity looms in implementing privatization strategies. African peoples of both nations fear that privatizing will result in the control of important sections of the economy into the hands of minority Indian groups.

In the past, African countries, such as Malawi, prohibited Indians from participating in bidding on privatized enterprises.<sup>14</sup> However, taking restrictive approaches like this one are not long-term solutions to the problems of ethnic imbalances created through privatization. Creative alternatives are being devised by governments to address local, ethnically based concerns. Countries such as in Uganda have developed a program to return properties to once departed Indians as one way to restore stability and equality.

**Monopolies**

The sale of SOEs without the proper regulations and regulatory institutions in place can also lead to the creation of monopolies. Monopolies are generally viewed as harmful to an economy and its consumers. In more recent years, their sales have been completed based on the premise that it would maximize financial and economic returns to the government.

In natural monopolies, such as utilities, privatization does not necessarily mean more choice or lower prices. Unless properly regulated, privatized monopolies may continue to operate in a manner that is less than optimal for consumers.

The issue of ownership concentration is important to the sustainability of privatization programs. To some extent, ownership concentration precipitated nationalization and the long term situation will remain bleak if these fundamental inequities are not addressed.

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<sup>13</sup> Shirley, Mary, et. al., *Privatization: The Lessons of Experience*. Washington, D.C.: World Bank, 1992. p. 19.

<sup>14</sup> Wortman, Miles. *Africa Private Sector Development*. Labat Anderson. Washington, D.C.: USAID, 1992. p. 39,

### ***Consumer Prices***

There is very real cause for apprehensions over the potential for rapid escalation of prices after privatization. Many consumers have been protected for years -- even decades -- from having to pay market rates for nationalized goods and services. As a result, privatization and trade liberalization can result in increased costs to consumers, such as is taking place in Russia. Price increases, however, do not always occur after the sale of an SOE and practitioners can point to cases where prices declined after privatization due to increased competition. This has often happened when marketing board monopolies have been abolished.

Nonetheless, higher prices can often be a short-term outcome of privatization. Higher prices for basic goods such as food and fuel can be harmful to the poor, particularly the more politically volatile populations of urban areas. (Higher food prices help those rural poor who are net good producers.)

### ***Political Instability and Anti-Democratic Movements***

As noted in the previous section, privatization is a political process. Large scale privatization is highly visible and can affect a broad section of society including bureaucrats, labor, academics, and consumers. Implementing privatization programs can be a politically daring move that could jeopardize a country's political stability.

Recent developments in Russia indicate how a government's attempts to privatize and restructure can result in widespread political and social resistance that generates a wave of national sentiment.

The political risks associated with privatization must be well understood and addressed before an initiative is undertaken. This assessment may mean the termination of the privatization strategy, a reevaluation of the privatization approach, or the formulation of a targeted approach to address these issues.

### ***Regulation and Environmental Degradation***

The privatization of large, small, or medium assets will test a country's laws as well as its regulatory institutions' capacities. The lack of appropriate systems to ensure the protection of the environment, as the private sector gains control of an economy, can lead to disastrous effects.

At a University of Oregon School of Law-sponsored conference (March 1994), representatives from Russia, Ukraine, Uzbekistan, Bulgaria, Romania, Slovakia, Poland, and Hungary painted a bleak picture of environmental protection in their countries. They noted that while some countries have new environmental laws, and others are pushing for them, none are rigorously

enforcing them as economic growth, privatization, and basic survival take precedence.<sup>15</sup> Lack of capacity on the part of regulatory institutions was noted as one of their primary problems in this respect.

The case of Eastern Europe and the former Soviet Union suggest to the world community the risks associated with rapidly opening economies to free market forces. Although many of these countries had existing environmental problems, privatization has not yet succeeded in bringing the expected environmental benefits through access to new technologies. The future will determine if the newly emerging private sector in Eastern Europe will be able to support a cleaner, healthier environment.

Host country governments need to be aware of these risks and devote resources to revising laws and strengthening and building regulatory institutions that will regulate and sustain private sector growth.

## CONCLUSION

There are a variety of country level conditions that influence when, and if, to privatize. A country's political will is the most pivotal factor.

Although there is no simple privatization model, it is critical to define objectives clearly and develop a program that reflects political, social, and economic strengths and weaknesses. Even a properly designed and implemented privatization program will have unexpected outcomes; these risks should be approached with flexibility and innovation.

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<sup>15</sup> *Christian Science Monitor*. "Hopes of Ecological Bliss Elude the former Soviet Bloc", March 16, 1994. p. 6.

## **CHAPTER II**

### **USAID'S PROGRAMS**

USAID's formal policy on privatization was announced in February 1986. The rationale for this strategy was based on the tenet that privatization was a vital component of economic development. In terms of sustainable development, privatization was seen as a mechanism that allowed governments to reduce their debt burden and increase service delivery<sup>16</sup>, support the expansion of local private sector-led growth, and provide a catalyst for more open and competitive market economies.

USAID has played various roles in supporting privatization around the world. Programs have emphasized an informational approach, and included technical assistance and financial support.

#### ***Information Assistance***

USAID has often played the role of information provider for countries that are still contemplating privatization. This type of assistance has included furnishing governments with studies on the costs and benefits of privatization; assisting in general assessments of country-level needs, risks and benefits of privatization; support in developing appropriate strategies; and supplying access to other countries' experiences.<sup>17</sup>

A noted example of informational assistance was the role USAID/Tunis played in sponsoring a conference on the costs and benefits of privatization in Tunisia. This assistance was provided in response to public and private leaders' concerns about the repercussions of privatization on the social, economic, and political fabric of the country. Subsequent reports note that this initial USAID assistance helped convince many of the conference participants that privatization was an essential tool of government, and initiated a process that led to the creation of an ambitious divestiture program.<sup>18</sup>

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<sup>16</sup> The sale of State Owned Enterprises (SOEs) can financially support the provision of public services such as health care, education, transportation. In the late 1980s, countries such as Bolivia sacrificed their public services when SOE losses accounted for more than two-thirds of the government's overall budget deficit.

<sup>17</sup> For example, USAID/Dhaka sent several Bangladeshi leaders to Thailand and Korea to learn about their experiences with privatization.

<sup>18</sup> USAID. *Trends and Benefits of AID's Privatization Program*. Washington, D.C.: USAID, 1990. p. 36.



Cases of failure also exist when USAID's efforts came too soon in the political process. Peru stands out as an example of lack of political will to implement a USAID-supported privatization strategy. In Peru, USAID helped set up and advised a Privatization Task Force staffed by high level government officials. The Task Force never made any decisions, however, and no formal actions were taken by the government.

### ***Technical Assistance***

USAID has provided technical assistance to governments that have adopted privatization strategies. This has included: revising legal systems, financial markets assessments and improvements, institutional strengthening, and valuation. Advice is also given on privatization techniques, SOE debt burden restructuring, complete or partial divestiture decisions, and sales financing.

It is common for USAID to provide technical assistance on a project-specific basis, such as the sale of an identified SOE or a group of SOEs. To this end, the trend has been for Mission staff itself to provide the technical assistance for many agriculture-related privatization activities in Africa and poorer Asian countries, such as divestiture of seed production, fertilizer marketing and distribution, forestry, irrigation, and crop storage facilities.<sup>19</sup>

In industry and commerce, technical assistance usually is provided by an outside expert consultant since these transactions require highly specialized skills including valuation, market analysis, labor relations, and investment banking. The Mission's assistance to the Government of Jamaica is an example of USAID providing expert consultants to assist in the sale of the National Commercial Bank.

### ***Financial Assistance***

USAID Missions may provide financial aid to leverage/encourage the privatization process. For example, Economic Support Funds (ESF) have been used by several Missions to help move the government's privatization agenda forward. The Dominican Republic presents an example of the use of ESF monies to reward the government for meeting specific privatization targets.

Other funds come from PL 480 resources. Missions have been creative in using these funds, from linking PL 480 support, to attaining privatization targets, to using local currency proceeds, to realizing privatization goals.

In addition, Missions have used local currency trust funds for privatization activities. For example, the Mission in Honduras financed the Honduras' Divestiture Implementation Unit and USAID/Cairo provided loans to parastatals during a partial privatization.

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<sup>19</sup> USAID. *Trends and Benefits of AID's Privatization Program*. Washington, D.C.: USAID, 1990. p. 38.

## **BENEFITS OF USAID'S PRIVATIZATION PROGRAM**

A well planned privatization program can achieve only as much as country conditions permit. A strongly supported government-donor privatization program can vary in its success accordingly: a good plan + a weak economy = no change; a good plan + a strong economy + bureaucratic resistance and ineptitude = no change. In the end, a successful privatization effort may be more directly linked to the capacity and orientation of a government's bureaucracy than to donor assistance. Consequently, privatization is likely to be more difficult in least developed countries.

Nonetheless, there have been economic gains in even very difficult economic and social conditions. For example, in Niger the shift from 100 percent public to 75 percent private ownership revived a near dead textile company. It now operates profitably at close to full capacity and with an increased number of employees, exports much of its production, and has won a large domestic market share against imports. This success and others like it are indicators that, with the proper approach, qualified by country conditions, privatization can support sustainable development.

It is beyond the scope of this report to determine the impact of USAID's privatization efforts. The lack of attention to impact at the country level makes it difficult to assess USAID's privatization programs. However, it should be noted that there are many evaluations of privatization projects that have judged privatization's success in immediate terms (e.g., number of assets sold) and not longer-term impact (e.g., employment, profitability).

The Honduras Mission's efforts are an outstanding exception to relying on immediate measures of privatization's success. While Annex A gives a thorough description of the program, the following highlights some of USAID/Honduras' estimated benefits of their support for the government's privatization program:

- The creation of over 2,000 new permanent jobs;
- A \$29 million reduction in the government's external debt; and
- The generation of over \$18 million in new investment for current plants and new equipment.<sup>20</sup>

Successful USAID efforts at partial or full divestiture include endeavors in Bangladesh, Jamaica, and Costa Rica. Jamaica offers a good example of privatization's beneficial influence on the

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<sup>20</sup> Excerpt from USAID/Honduras' summary of its privatization program.

economy, resulting in the significant improvement of Jamaica's capital market.<sup>21</sup> Other programs that may have a more limited, but still significant, impact include the Dominican Republic's contracting out of all waste collection services in Santo Domingo to private firms.

USAID Missions have also achieved limited impact through the creation of competition for government owned monopolies. For example, in Niger, the Mission helped establish a system of private pharmacies to compete with government owned pharmacies. In Mali, the Mission helped establish a private trucking system to haul cotton from farm to city in competition with government transport. Once in operation, more than 80 percent of the cotton was subsequently hauled by the new private sector transporters.

Although it is difficult to determine long-term impact from these anecdotes, some common characteristics of successful projects emerge:

- Country-level, preliminary assessments of the risks and potential stumbling blocks associated with privatization were assessed and addressed.
- Strong political support existed -- or only low visibility/smaller assets were privatized where political repercussions were not an issue.
- Projects were properly planned and had clear, realistic goals and expectations.
- The privatization process was transparent but coupled with an appropriate system of checks and balances to ensure integrity and credibility.
- The privatization process was managed through an autonomous, central mechanism that was invested with the necessary authority to effectively coordinate the process.
- Projects were part of a broader strategy (supported by the government) of expanding the role of the private sector.
- All stakeholders were involved in the decision to privatize large and/or politically sensitive enterprises.

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<sup>21</sup> In Jamaica, an extensive education campaign about capital markets preceded the public share offering from the National Commercial Bank. As a result, NCB shares were oversubscribed by 2.7 times.

As noted above, USAID's privatization programs have been too focused on immediate, short-term measures of success. This approach to defining success has overlooked the fact that privatization should be considered a development tool that can support a more efficient private sector. As such, the long term improved performance of firms should be the true indicators of successful privatization.

## **WHAT DOES USAID DO BEST?**

Key informants expressed a wide range of ideas on USAID's institutional forte.

- USAID can provide "models" of successful privatization strategies and approaches.
- USAID's institutional knowledge and experience on privatization facilitates cross-regional learning.
- USAID's in-country presence in developing countries gives it greater visibility and influence with host country government officials.
- USAID has contracting vehicles (such as IQCs - Indefinite Quantity Contracts - and work orders) that can allow quick and responsive actions.
- USAID has the capacity to identify and provide specialized technical assistance in areas such as finance, accounting, legal property rights, and management.

One key informant's narrative of USAID's privatization work in Russia sums up the general tone of many informants:

In the case of the Russian program, it was felt that USAID has had a "big bang for its buck" as a result of: (1) being quick and responsive to the country's needs; (2) USAID's in-country presence that has supported collaborative working relationships with GKI (the state privatization entity) and other officials; (3) a "snow-balling" effect from the Mission's work with the GKI in developing a good privatization model<sup>22</sup> - other donors have followed suit; (4) USAID's work to get the private sector involved in the privatization process; and (5) USAID's provision of grants rather than loans has allowed them more leverage with the host country government in the use of these funds.

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<sup>22</sup> Note: Through the use of the IFC as an executing agency, USAID was able to fund the first Russian privatization program in the city of Nizhny Novgorod.

Key informants expressed the view that USAID's development oriented agenda was a strength. Since many of the donors working in privatization are development banks, such as the World Bank, USAID's grant assistance was seen as unique.

As a grant assistance organization with a focus on sustainable development, USAID's privatization programs are often part of a larger private sector oriented strategy that dovetails with its work in health, the environment, and democracy. As such, key informants felt USAID's broad-based development mandate gave it greater flexibility that helped ensure support of programs affecting the poor and disadvantaged.

Countries such as India and Indonesia are seeking alternatives to outright privatization by allowing greater competition and open systems in their economies. In these and other situations, USAID can capitalize on its institutional forte as a development agency to support an agenda that includes priorities on private sector development, democracy, the environment, and health care.

## **DONOR COLLABORATION**

The majority (70 percent) of those interviewed rated USAID as having a fair or poor record of collaborating with other donors in privatization efforts. Although this varies significantly country by country, there was general consensus that the Agency needs to do more to improve donor coordination. These conclusions are supported by recent studies such as the 1993 evaluation of USAID's privatization efforts in Eastern Europe, which stated that "donor coordination [is] weak and bureaucratically hobbled." <sup>23</sup>

However, the same evaluation went on to note that there were examples of USAID attempting to link its work with other donors. In Hungary, under the COMPASS program, parts of the original scope of work were deleted because of the European Community's PHARE involvement. Similarly, USAID did not pursue a role in the Czech Ministry of Privatization because the British Know How Fund was already providing similar support.

Explanations by respondents for the lack of donor collaboration centered around donors' competing agendas. Competing agendas are a reflection of the different funding approaches and ideologies that make it extremely difficult to develop common or complementary country strategies. For example, USAID's inability to co-mingle its funds with other donors has limited its ability to integrate its approach and funding resources with a large-scale multi-donor effort in Egypt.

Many informants also alluded to the fact that the entire collaborative process was too informal. In practice, it is the responsibility of project officers to develop a system to exchange

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<sup>23</sup> Privatization Phase II Program Evaluation. Prepared by Louis Berger and Checchi. Washington, D.C., USAID, 1993, page 21.

information and coordinate actions. The result is often a lack of uniform sharing ideas, project concepts, and lessons learned.

Other factors that limit donor collaboration noted by informants include differences in:

- Priorities and resource levels donors have allocated to a country;
- Donors' interests in working on a particular project; and
- Donors' abilities to maintain staff to work on project design and implementation on a medium- to long-term basis.

These points have been supported through other sectoral research on donor collaboration. For example, a recent GEMINI report noted that the problems facing coordination among donors working in the microenterprise sector are tremendous, entailing: personal ambition among the managers of some donor agencies, the requirement to move money, national policies and guidelines they must observe, hidden agendas for the aid process, and territoriality.<sup>24</sup>

A senior World Bank officer offered another explanation for limited donor coordination. She attributed these problems a host country government's weak institutional capacity to deal with multiple donors simultaneously. For example, donor collaboration could be viewed as good in countries such as South Korea and Botswana where institutional capacity is strong. Conversely, it has been not as good in Tanzania due to weak government structures. In essence, countries that set professional attitudes and maintain well-organized bureaucracies can anticipate and specify how coordination should take place among donors.

These findings point to a larger and more important problem among donor programs: although donors negotiate project goals and objectives with host country governments, there is no formal arrangement among donors to coordinate their individual projects during design or implementation. As such, governments are left on their own to struggle with multiple sets of goals, fiscal funding cycles, and reporting procedures. The outcome is a set of projects that may have contradictory objectives and government ministries that spend much of their time managing conflicting donor portfolios. In the long-run, these approaches can only impair sustainable development efforts.

### ***Focusing on Strengths***

What seems to be lacking from the donor collaboration process is an understanding of other donors' agendas, skills and expertise, and modes of operation. It is easy for project officers to get caught up in daily implementation issues and forget to look at the other players active in

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<sup>24</sup> Grant, William. *A Review of Donor-Funded Projects in Support of Micro- and Small-Scale Enterprises in West Africa*. GEMINI. Washington, D.C.: USAID, 1993. p. 68.

a sector and how their work complements that of their own organization. As noted in a 1993 GEMINI report on donor initiatives in microenterprise development:

To achieve this ideal of sound development programming, the donors must share more information and must also have in place a means for knowing what is already being done, by whom, how, and why so that they don't needlessly replicate programs or duplicate expenses. By and large, the donors have failed in this respect across West Africa, financing projects that sometimes duplicate each other and sometimes actively compete with each other; once in a while poorly-thought-through and unsustainable donor initiative undoes the work of other donor projects and initiatives.<sup>25</sup>

USAID and other donors must understand their relative strengths in order to capitalize on skills. The World Bank and USAID's efforts in Bolivia offers a useful example of successful collaboration, presented in Box II-A.

**Box II-A**  
**PENSION FUNDS IN BOLIVIA**

In La Paz, USAID holds claim to a success story of donor collaboration in support of a social security pension fund. One of its Project Officers noted that it was one of the "most productive" donor collaboration efforts he had worked on.

In Bolivia, the World Bank and USAID both have different kinds of resources and contracting systems. A very fluid partnership arose in support of the pension reform initiative spearheaded by the Ministry of Finance. Technical support was provided by USAID or the World Bank - depending on the technical needs. USAID eventually passed several million dollars of its funding to the World Bank, in the form of a grant, in order to place the funds under the Bank's more flexible procurement policies. These funds have helped provide the necessary technical assistance that has supported the new government's announcement of its intention to submit the Pension Reform Law in April of 1994.

So far, the USAID/La Paz Project Officer adds "It's been working like a charm...without the close collaboration of USAID and the World Bank, it is impossible that the vast demographic, financial and other technical analysis -- which were necessary to launch this reform -- would have taken place."

***A More Collaborative Strategy***

The range of donor initiatives is too broad and complex to propose a comprehensive model for collaboration. A more formalized exchange of information needs to be advocated from the senior ranks and supported by the necessary resources. A formalized, collaborative process takes time, money, and human resources and will be unsuccessful at the working level unless its importance is elevated.

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<sup>25</sup> Grant, William. *A Review of Donor Funded Projects in Support of Micro- and Small-Scale Enterprises in West Africa*. GEMINI. Washington, D.C.: USAID, 1993. p. 68.

Concepts to address in developing a formalized, collaborative process include:

- Encouraging transparency and honest information sharing.
- Anticipating and avoiding policy conflicts and project level duplication.
- Developing systems for regular, well organized meetings, conferences, and workshops.
- Advocating the use of better (and more uniform) monitoring, evaluation, and data collection methods.

In sum, communication channels and working level trust must be cultivated that support the formation of policy and project guidelines that do not impinge on the decision making authorities of associated donors. Realistic expectations must be advocated and developed -- supported through various levels of dialogue and communication.

## **CONCLUSION**

USAID has an impressive history of supporting privatization around the world. It has played an important role in leading privatization efforts and supporting those of other donors.

Donor collaboration on privatization initiatives is still weak. Donors need to develop a better understanding of their own strengths and weaknesses and focus on their comparative advantages. A great deal of time and resources need to be devoted to developing a more effective donor collaboration process.



## **CHAPTER III**

### **PRIVATIZATION'S LINKAGE WITH USAID'S STRATEGIES**

Privatization can positively contribute to building civil societies and strengthening democratic systems, improving the effective delivery of essential services, and developing appropriate environmental policies.

Privatization has usually been justified in terms of its effects on one of USAID's strategic areas - economic growth. Below is a short review of USAID's other priority sectors, how these portfolios are influenced by privatization efforts, and how they can be more strategically integrated in the future.

#### **DEMOCRACY**

The relationship between economic growth and democracy has been extensively debated for decades. A range of views currently exists on the relationship, although in general scholars of democracy acknowledge an interdependence.

Beyond the arguments on this subject is an assumption that donors can make a contribution to moving the democratic process forward through its economic development agenda. To quote from a 1990 democracy literature review:

The role of foreign assistance is limited by the underlying social and cultural conditions of any country. Nonetheless, foreign assistance can facilitate democratization by fostering a more favorable climate through support of liberalization and economic development efforts. Economic assistance can help democracies consolidate their power and avoid crises of legitimacy that can lead to the breakdown of the newly established democracy.<sup>26</sup>

The link between privatization and democracy is one step removed from these deliberations, however, and has been given far less attention. If the assumption that privatization can improve a country's economy is accepted, then it can be indirectly linked to supporting more democratic institutions and perspectives.

Key informants for this study stressed the close relationship they found between privatization and strengthening democratic institutions. These experts frequently pointed to the case of Eastern

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<sup>26</sup> Wong, Melissa. *Perspectives on Democracy: A Review of the Literature*. PRE. Washington, D.C.: USAID, 1990. p. 29.

Europe as an example where privatization has spurred the building of democratic systems. For example, one respondent noted:

**"Privatization and economic growth have completely fueled democracy in Poland."**

Privatization's support of democracy in the developing world was considered important to key informants because of the changes it was bringing to political systems. At the institutional level, privatization was seen as a driving force in making the public and private sector more accountable for their actions and encouraging transparency. At the public level, privatization's education and awareness campaigns<sup>27</sup> give citizens greater access to information and the ability to make better, more informed decisions. At the individual level, privatization exposes workers to group decision making and offers employees an opportunity to vote on labor issues, hiring practices, and pension issues.

On the other hand, recently emerging problems in Russia may presage issues for the future. The Russian government is currently experiencing a backlash to their privatization strategy and economic reform agenda that is decidedly anti-democratic. It is too early to gather lessons for the future from these events, especially as Russia's program and the country conditions are relatively unique. This backlash indicates, however, that privatization and democracy building are fraught with trade offs that are critical to try to understand and address before programming decisions take place.<sup>28</sup>

At the same time there are also many relatively unexplored ways that privatization and democracy can reinforce each other. USAID's democratic strategy should investigate these areas and perhaps initiate a more integrated, effective approach that considers the relevance of economic growth and privatization to the strengthening of civil societies.

USAID's experience indicates the merit of continuing to explore the possibilities of:

- Targeted programs that can address difficulties that arise during the economic development and democracy processes, such as labor training programs for displaced workers, and social safety net programs for the poor and disadvantaged.
- Assisting governments in developing legal structures that encourage more open and dynamic privatization schemes that incorporate increased access to information and public participation in divestiture decisions.

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<sup>27</sup> Privatization efforts may be accompanied by programs that attempt to teach the public (or identified groups) about privatization's realistic positive and negative consequences.

<sup>28</sup> That none of the key informants interviewed for this study noted this trend and its potential significance seems to be further indication of the need to better understand and integrate these two fields if compatible, supportive programs are to be developed.

- Developing the appropriate legal and regulatory framework to encourage the use of innovative privatization techniques (such as vouchers) that demand consumer education and awareness.
- Developing better communications and information bases for the public and private sectors investing in broadcast and print media to reinforce freedom of information, diffusion of modern communications technology, and educational awareness and outreach programs.
- Building or strengthening institutions for the public and private sectors to explore the issues of accountability, transparency, and corruption, such as trade associations, accounting firms, lobbying groups.

In the long term these programs can have a broad impact on political and economic systems in terms of developing:

- More stable and efficient economies;
- Improved economic equity; and
- Greater broad-based participation in economic and political decision making.

## **PREVENTATIVE HEALTH CARE AND OTHER SOCIAL SERVICES**

Developing country governments in Africa, Asia, Latin America, and the Newly Independent States are struggling to meet their citizens' needs for adequate health care and other basic services. Competing priorities and poor economic conditions often result in limited government expenditures in these areas.

Two distinct issues arise regarding private sector involvement in this area. First, there is the issue of whether the government or private sector provides the services, irrespective of who pays for it. Second is the issue of who pays for the health care.<sup>29</sup>

Private sector health care delivery has been claimed to be a cost effective alternative to government operation. A 1988 paper on the private sector and health care delivery in developing countries argues that, "as the Agency pursues a strategy of renewed attention to sustainable policies, the private sector's capacity to recover operation costs holds out an

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<sup>29</sup> Government resources are often said to be used most effectively if they pay only for the care of those who can't afford it.

opportunity for the health sector."<sup>30</sup> Conclusions from this and other empirical studies suggest that the private sector can provide a higher quality service while operating on a fee-for-service basis.<sup>31</sup>

To determine the appropriate "mix" of the public/private provision of health care, the type of service provided is a key determinant. Experts contend that the public sector should focus on the delivery of health services that are "public goods", for example, immunization and other preventative health care services. Oral rehydration therapy (ORT), pre- and post-natal care are less clear-cut public goods. Although governments can subsidize these goods and services for low income individuals, the general population is often able to purchase them. Curative services are in general often noted as prime candidates for private sector intervention as they are clearly not public goods.

Beyond the delivery issues there remains a concern of "who pays?" for health care services. Studies undertaken in developing countries indicate that many consumers already pay for health care. In the aggregate, conclusions indicate that patients in developing countries are more likely to buy health services from private providers than are those in developed countries.<sup>32</sup>

Privatization can play a role in providing more efficient and effective health care and other basic services. Governments around the world are considering privatizing public services as they recognize their inability to meet the public demand for adequate health care services, water and sewage systems, transportation, and access to telecommunications.

Although the appropriate roles for privatization and private sector involvement in health care delivery are debatable, private sector healthcare has the potential to free up government revenues to invest in other services such as rural roads, communicable disease control, and other infrastructure and services that can only be provided effectively by the public sector.

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<sup>30</sup> Lewis, Maureen. *The Private Sector and Health Care Delivery in Developing Countries: Definition, Experience, and Potential*. Washington, D.C.: USAID, 1988. p. 7.

<sup>31</sup> See: Charles C. Griffin's *Strengthening Health Services in Developing Countries through the Private Sector*. International Finance Corporation, 1989; and *USAID Sustainability Strategy (Africa Child Survival Initiative, 698-0421)*, 1991.

<sup>32</sup> Lewis, Maureen. *Private Sector and Health Care Delivery in Developing Countries: Definition, Experience, and Potential*. Washington, D.C.: USAID, 1988. p. 10

Although key informants expressed concern about USAID's lack of attention to the private sector's role in providing more efficient public services, successful cases do exist. In Bolivia, for example, USAID was involved in a successful case of contracting out a solid waste collection system; in Jamaica the Mission has also assisted the government in privatizing the laundry and housekeeping services for four large Kingston public hospitals.<sup>33</sup>

The USAID centrally funded, Enterprise Program is another good example of the Agency's commitment in this area. Since late 1985, one of the ways the Enterprise program has sought to expand the role of the private sector has been to support non-governmental organizations (NGOs) involved in family planning service delivery. Enterprise support to family planning NGOs has focused on establishing greater financial self-reliance and sustainability. One of its success stories includes assistance to the Hospital Sofia Feldman in Brazil which now covers almost half of its entire family planning program costs from revenues generated from the improved laboratory sponsored by Enterprise.<sup>34</sup>

As countries such as Indonesia, India, Vietnam, and Zimbabwe consider a greater role for the private sector in delivering basic services, USAID should strive to dovetail its economic growth and health strategy to ensure more viable and effective public service delivery around the world.

The private sector can play an important role helping governments deliver better health care and other basic services. USAID's experience indicates the merit of continuing to explore:

- Ways the private and public sectors, together, can meet developing country needs for adequate water supplies and waste disposal, health care services, family planning, and transportation systems.
- Innovative approaches to the public and private sector working collaboratively to provide health and other basic services, through such mechanisms as contracting out, fee for service, and so on.
- Avenues to promoting private sector health care and other basic service provision:
  - Consider the viability of tax incentives, improving private access to capital, and encouraging private sector skill development.

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<sup>33</sup> Lewis, Maureen. *The Private Sector and Health Care Delivery in Developing Countries: Definition, Experience, and Potential*. Washington, D.C.: USAID, 1988, p. 20.

<sup>34</sup> Fort, Catherine. *Promoting NGO Sustainability: The Lessons of Enterprise*. John Snow. Washington, D.C.: USAID, 1991. p. 5.

- Address the existing legal and political obstacles to greater private sector involvement in health care provision.
- Assess private sector access to information and communication services that can facilitate the effective delivery of health care.
- Developing private and/or public insurance systems that can affordably address local needs, and overcome the impediments to expanding health insurance and other private financing mechanisms.
- The private sector's ability to recover costs and increase efficiency, thereby making service delivery more sustainable.
- Supporting research on innovative, alternative financing mechanisms.
  - Explore methods of public reimbursement for the private provision of health care to the needy.
- Building equity into the private delivery of health care services.
  - Support the development of more equitable approaches to government subsidies, such as vouchers for the poor who cannot afford to pay

In the long term, these initiatives could have a broad-based impact on health and economic systems in terms of delivering:

- Better quality and more equitable access to health care and other basic services.
- More effective use of existing government resources.
- Lower cost, more sustainable health care delivery.

## **THE ENVIRONMENT**

USAID's priority to support the sustainable use of natural resources is reflected in its policies and programs on the environment. The Agency's 1993 Environment Program Report states:

Concern for the environment and for sustainable use of resources is central to USAID's assistance program. Wise management of the natural resource base is an absolute requirement for successful development for two interrelated reasons: (1) environmental degradation undermines both immediate and long-term economic development; and (2) deteriorating economies exacerbate and accelerate environmental degradation.<sup>35</sup>

This policy statement reveals USAID's emphasis on linking economic growth and natural resource and environmental protection programs. Privatization - as associated with economic growth -- is also being tackled by addressing unsound energy production and use, urban and industrial pollution, and policy formation.

Privatization is seen as a tool that can stimulate the efficient use of resources like energy and water. Pricing of such resources by governments is often a political issue, prompting them to hold prices low, which encourages waste. Privatization is being advocated as a mechanism that can lead to market pricing of public goods that will lead to greater public and private efficiency in using these resources.

USAID's programs in the environment have become increasingly attentive to the demands privatization has created for new regulations and regulatory bodies. USAID's environment policies in Central and Eastern Europe (CEE) provide a useful example of how the Agency is dealing with the pervasive air and water pollution and natural resource degradation occurring in this region. USAID's environment strategy in the CEE advocates promoting economic, legal, and regulatory reforms, removing barriers to infrastructure investment and privatization, and supporting democratization in the region (including increased participation by the public and NGOs in government decision making).<sup>36</sup> It also encourages private sector investment in priority areas and the adoption of low cost, environmentally sound technology and management techniques through technology transfer, investment, and training.

Although new approaches may be needed, key informants noted that privatization had the potential to have a positive impact on the environment. For example, privatization that involves foreign investors may bring new, more environmentally friendly technologies and an adherence

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<sup>35</sup> USAID. *Environment Program Report FY 1992-1993*. Internal Working Document. Washington, D.C.: USAID, 1993. p. 7

<sup>36</sup> USAID. *Environment Program Report FY 1992-93*. Internal Working Document. Washington, D.C.: USAID, 1993. p. 115.

to *international* environmental standards. Applying these standards in countries that have weak or non-existent environment policies can support their implementation on a wider basis.

Privatization can also prompt the improvement of environment standards. Regions such as Eastern Europe and the NIS are rewriting many of their environment laws to meet Western standards. For example, in the Czech Republic and Poland, ongoing efforts to design and implement new environment regulations ensure the private sector's compliance with Europe's environmental standards. These efforts will facilitate trade and investment between Western and Eastern Europe as many developed and developing nations move to comply with the new GATT standards.

There are still many unanswered questions regarding how privatization and the environment affect each other. Each region has a unique set of environmental conditions that make cross country comparisons difficult.

In Africa, where governments may focus on the privatization of agricultural marketing boards or fertilizer distribution systems, environmental concerns center on issues such as land tenure, transportation systems, and water resources. Latin American countries privatizing utilities may focus on developing environmental protection standards that can protect consumers and prevent the formation of monopolies. Eastern Europe's concern is on its ability to handle concurrent, multiple issues such as land use, policy formation, industrial practices, and enforcement of standards.

The greatest impact USAID can achieve is through linking sector objectives to consolidate resources and suggest complementary solutions to developing world problems. USAID's privatization agenda can support its environment programs, and its experience supports the exploration and consideration of the following:

- The interrelationship between environment programs and the private sector initiatives being undertaken throughout the world.
  - Build on initiatives that have proven effective for both the environment and the private sector.
  - Help emerging private sectors explore the cost savings associated with safer environmental practices.<sup>37</sup>

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<sup>37</sup> For example, on-going USAID-funded industrial waste minimization programs in the Czech Republic, Poland, and Romania have reduced pollution and increased profitability, saving the plants millions of dollars.



- The most effective manner to encourage partnerships between U.S. and developing country environment NGOs. In turn, these may be able to develop fair and effective mechanisms for the democratic review of government and private sector decisions affecting the environment.
- A policy mix that can most effectively enforce regulation of damaging environmental practices while still encouraging private sector development and the application of new environmental technologies.
  - Investigate the potential of levying environment fees and user charges on newly privatized firms.
  - Link privatization's education and awareness programs to the issues of natural resources management.
  - Raise awareness, provide funds for assessments, and incorporate an environment agenda into sales strategies and agreements.

### ***Non-Governmental Organizations***

Working in partnership with non-governmental organizations (NGOs)<sup>38</sup> is a priority of the Clinton Administration. The Agency has identified NGOs -- including PVOs (U.S. based private, voluntary organizations) -- as important development partners for the delivery of needed goods and services throughout the developing world.

USAID sees NGOs as key to fostering a more sustainable development process. Their potential in this domain is felt to stem from their:

- Participatory approach to project implementation;
- Long-term, in-country presence;
- Employment of innovative methods and models;
- Understanding of local needs and conditions; and
- Low cost systems of operation and administration.

Privatization touches on the role of NGOs in several ways. First, privatization can be a catalyst for creating NGOs in nations where the government is no longer providing traditional public services. Second, privatization can strengthen incipient NGO communities through increased flows of resources, manpower, and technology into private hands.

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<sup>38</sup> NGOs are defined as not-for-profit organizations that are operated by private, not public, management units. NGOs usually work on behalf of a constituency from which they receive financial and/or in-kind support.

NGOs are springing up throughout the developing world as vehicle for delivering services to less accessible urban and rural populations. Several African countries have attempted this tactic by supporting the development of new, privately run health clinics (managed and run by NGOs) to operate on a fee for service basis. This new "privatized" sector is now capable of meeting the health care needs of local citizens previously overlooked by publicly run clinics.

Although the direct linkage between privatization and strengthening and creating NGOs has not been adequately studied, there is some evidence to support the relationship. The recent privatization efforts in Russia provide an example of the development of an NGO community. Historically, state-owned enterprises (SOEs) dominated the Russian economy. The privatization of large portions of Russia's economy has triggered the development of NGOs to meet needs for services that are no longer being met by the government.<sup>39</sup> Consequently, the Russian NGO community has grown enormously in the past two years partly as a result of privatization.

As governments around the world look for methods to reduce their costs and provide more effective public services, NGOs are being given more attention. Areas such as education, health care delivery, rural water systems, and environmental education have all been undertaken by NGOs. These and other basic services may be the best domain for non-profits to meet the public sector's resource gaps. Other efforts -- such as the privatization of large-scale utilities - - may not be appropriate for NGO initiatives, owing to their requirement for large capital investments.

Privatization can complement the Agency's efforts to work with and strengthen NGOs. In the future, greater attention could be given to:

- The role of NGOs in a privatization agenda.
  - Assess how the NGO community can be used to meet some of the needs raised through privatization, such as: the need to train displaced labor, health care services, and so on.
  - Develop plans to support the transfer of resources and technology to NGOs as part of a privatization program.
- How best to evaluate NGO's comparative advantage vis-a-vis other delivery mechanisms.

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<sup>39</sup> As a result of SOE ownership of neighborhood services that supported the local community (including schools, health clinics, housing, transportation), privatization in Russia has sometimes resulted in these services falling into the hands of the local, non-profit sector.

In the long term, these programs can have a broad-based impact on social, political, and economic systems in terms of:

- Creating private sector organizations that can be a voice in policy level decision making.
- Strengthening the ability of the private sector to challenge public services through higher quality, more cost effective delivery.
- Offering a wider variety and greater access to public goods such as education, health care, and water and sewage.
- Providing a healthier and more stable environment through which society and the economy can prosper.

## **CONCLUSION**

USAID's decision makers need to continue to explore ways they can help government's meet their countries' needs in terms of: health care and clean water; protecting existing natural resources and the environment; and ensuring stable and accountable governments. A well thought out and integrated privatization strategy can support these goals by encouraging greater private sector participation and creating a more balanced, public/private mix to public service delivery.

USAID's ongoing efforts in democracy and governance, health care and basic services, and the environment could all benefit from an assessment of where privatization "fits" into their overall development strategy.

## **CHAPTER IV**

### **CONCLUSION: PRIVATIZATION'S CHALLENGE**

The major theme running throughout the previous chapters has been the centrality of country conditions in determining when to privatize, how to privatize, and privatization's impact. Built on this vital premise must also be the realization that privatization is a process -- not an end in itself -- that can be used in conjunction with a variety of other mechanisms to achieve long-term sustainable development.

Below is a brief overview of some of privatization's regional challenges.

#### **REGIONAL ISSUES**

Every country has a unique set of conditions that must be met to achieve a successful privatization program. Below are a few trends that may influence USAID's country programming.

##### ***Central and Southern Africa***

Many African governments are still studying the concept of privatization and weighing its potential impact on their economies. Most African nations are not ready to embrace a large-scale privatization strategy as many retain a deep-rooted fear of foreign and elite ownership of privatized government properties.

Countries that experienced nationalization in response to outside and elitist ownership of assets are still faced with the legacy of how to deal with the short- and long-term implications of privatization. In Zimbabwe, a 1993 article on privatization reflects some of the sentiments voiced throughout Africa:

Privatization promoted by the IMF and World Bank has had adverse effects on food security; and the government needs to consider the negative effects the structural adjustment program has imposed on its citizens and endeavor to come up with viable policies.<sup>40</sup>

If privatization is to occur in Africa, it will need to be on a more limited scale with modest goals that clearly meet the development objectives of each country. Practitioners and scholars have

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<sup>40</sup> *The Financial Gazette*. "Effects of Privatization Will Hurt Consumers". January 21, 1993. p. 5.

given a great deal of attention to Africa's socially and politically complex economies but the problem remains of how to implement development programs realistically that do not lead to ownership concentration, economic collapse, or political instability.

In Africa, basic economic needs must top the agenda in a way that supports existing systems and does not undermine them. As such, greater attention could be given to partial divestiture, contracting out, and private sector management in the areas of: agricultural systems (seed production and distribution; irrigation systems; crop storage facilities, and so on), health care services (urban neighborhood health care facilities and rural clinics), as well as municipal services (local transportation, road maintenance, and water supply).

Targeted divestiture, such as the sale of one or more key SOEs or parastatals, has worked successfully in Africa. The Gambia presents one such example, selling the core assets (collecting, processing, and marketing groundnuts) of its Produce Marketing Board in 1993.

However, countries that are undertaking large scale privatization programs, such as Zambia, are faced with a set of problems that are indicative of the continent overall:

- Internal political and bureaucratic resistance to privatization;
- Lack of local capital or credit to purchase newly privatized enterprises;
- Labor resistance to potential layoffs and displacement;
- Public concerns over privatization's effects on their food security, ownership concentration, and government subsidies;
- General lack of understanding about privatization; and
- Businesses apprehension regarding trade liberalization and the removal of financial restrictions.

Limited privatization options do exist in Africa as long as they are couched in local terms. In poorer and more fragmented situations -- such as Mozambique -- targeted, small-scale partial divestiture may be an option. In wealthier, more market oriented economies -- such as Botswana -- broader privatization endeavors may be possible.

### ***Eastern Europe and the Former Soviet Union***

Many Eastern European countries have taken on fairly aggressive privatization programs in the 1990s. The resulting growth of the private sector has left governments faced with the daunting task of forming sustainable development strategies that can meet their needs.

The management training, marketing, and restructuring needs of newly privatized firms have been encapsulated in a term called "corporate governance"<sup>41</sup>. Corporate governance will be a high priority for Eastern Europe and the Former Soviet Union over the next decade. This factor was discussed in a recent Price Waterhouse evaluation of USAID's privatization experience in Hungary, Poland, and the Czech and Slovak Republics:

Adequate training and business education have emerged as critical success factors for these countries. The post privatization performance of companies in Poland, Hungary, and the Czech and Slovak Republics will be determined not only by the transition to private ownership, but to a large extent by the quality of the managers and directors....There is an evident shortage of trained and experienced managers, particularly in marketing, finance, and strategic planning.<sup>42</sup>

USAID can marshal the skills and expertise to address the corporate governance needs of Eastern Europe and the Former Soviet Union. To a large extent, these are transferable skills from the Agency's experience in non-formal education, management and business training, and skills formation. Its support in this area can help upgrade the skills and technology that will be necessary for these countries to compete and trade internationally.

USAID may also have to reshape its aggressive privatization approach in countries such as Hungary and Russia that are experiencing a backlash to privatization and may begin to slow down their programs. If USAID's strategies are to be successful in these emerging democracies, officials need to recognize the continued presence of socialist and nationalist sentiments that support the maintenance of subsidies to the public sector. USAID's privatization strategy must also address issues of joblessness and economic collapse that are of concern to politicians as well as the general public.

USAID's future assistance in this region will need to take all of these issues into consideration. As a result, the rate of privatization may slow down and USAID may begin to take on a role of improving SOE management and educational awareness rather than immediate privatization.

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<sup>41</sup> Corporate governance encompasses the structure of management (such as the boards of directors), the activities of the firm, and its strategic management in terms of production and marketing.

<sup>42</sup> *Privatization Phase I Program Evaluation: Early Experiences of Privatization in Hungary, Poland, and the Czech and Slovak Republics*. Prepared by Price Waterhouse. Washington, D.C.: USAID, 1993. pp. 29

## ***Latin America***

Latin America plays a unique role in USAID's privatization experience, due to a variety of successful privatization experiences. Chile, Mexico, Costa Rica, and Honduras all offer different, fairly successful models of implementing privatization.

The widespread implementation of privatization programs across the region makes it difficult to generalize about Latin America. In Nicaragua and Guatemala privatization endeavors are still unfolding whereas Jamaica has a fairly advanced program, and Chile's could be considered all but complete.

Beyond mere numbers of successful privatization campaigns, Latin America also offers a host of countries that are considering or have privatized their utilities. Chile and Argentina provide examples of successful utility privatization. Honduras is contemplating privatizing its telecommunications system and Nicaragua is considering privatizing its ports, state-owned banks, and petroleum marketing company.

To meet these diverse needs, USAID will need to supply targeted technical assistance geared to each country's needs. Innovative privatization strategies also need to be more fully explored in Latin America as well as other continents. These include methods of partial divestiture such as contracting out municipal services that has been carried out successfully in the Dominican Republic, Jamaica, and Bolivia.

## ***North Africa and the Middle East***

In general, the Middle East and North Africa offer a challenging opportunity for USAID to work in a limited and targeted manner to facilitate privatization and private sector development strategies.

One of the problems in the Middle East and North Africa is the need to accelerate opportunities for employment and income growth within private sector enterprises in the industrial, trade, and commercial services sectors as the region's population continues to grow at around 2-3 percent a year.<sup>43</sup> This region also incorporates a wide range of perceptions and practices of private sector led growth that limits USAID's capacity to support privatization.

In Jordan, for example, there is little interest in privatization. Tunisia, on the other hand, has undertaken an aggressive and successful privatization campaign. Egypt currently has the largest USAID-funded privatization program in the Middle East. Although there is massive donor funding and technical assistance for the Egyptian effort, there are very substantial constraints that must be surmounted, including: weak public understanding of privatization; limited political will

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<sup>43</sup> USAID. Action Plan. *Improving the Employment and Economic Contributions of Industry, Trade and Service Sectors in the NE's Sustainable Development*. 1993.

or government expertise to implement privatization; a weak financial market; and limited local investor capacity.

One of the critical factors in USAID's privatization strategy in the Middle East and North Africa is education and awareness efforts. There is a long history and tradition of government support and subsidization to the general public that is strengthened by regional religious beliefs about the appropriate role for the government.

To work successfully in this region USAID needs to build on successes, such as Tunisia which put significant time, energy, and resources into an education and awareness program to teach the public and influential groups about privatization.

### *Asia*

South and Southeast Asia provide USAID with another diverse set of economic, social, and political conditions. Some countries have embraced a privatization program and achieved substantial gains while others have taken limited privatization measures or none at all.

Sri Lanka, the Philippines, and Bangladesh are examples of countries with moderately successful USAID-supported privatization efforts. Each has taken a different approach to its implementation that has reflected its individual situations and needs. Sri Lanka's efforts stretch back to 1970s when the government began to reorganize the public sector and initiated programs to reduce subsidies and institute a more market oriented economy.<sup>44</sup> The government has been able to sell off most of its large, more attractive enterprises through a combination of tenders, public offers, and gifts of shares to employees. The Philippines has taken on a fairly aggressive privatization program that has struggled with implementation but continues to move forward. Bangladesh has taken a more limited approach, focusing on the diversification of its fertilizer distribution system.

Notwithstanding these efforts, such relatively advanced developing countries such as Indonesia have not chosen the path of privatization of existing SOEs, while Thailand has taken a fairly limited approach. The philosophy taken by these nations has been to support a broad-based private sector development strategy. For example, Indonesia maintains a strong, private sector growth strategy that concentrates on attracting private sector investment into areas such as infrastructure development, including water supply and solid waste services. The lion's share of manufacturing and trade is already in the private sector in these countries.

New programs are coming on line in such countries as Cambodia, Laos, and Vietnam. These nations' consideration of greater private sector participation in the economy extends an opportunity for USAID to consider new privatization programs in these areas.

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<sup>44</sup> In 1987 legislation was enacted that provided for the legal conversion of public corporations into joint-stock companies.



## TARGETS OF OPPORTUNITY

There are several areas that stand out as strategic targets of opportunity for the Agency in terms of its future privatization portfolio. They involve post privatization needs and partial divestiture schemes, including: (1) corporate governance; (2) new business development; and (3) contracting out.

### *Technical Assistance and Corporate Governance*

Privatization is only one element of a larger process to increase the efficient delivery of products and services to the public. If privatization is to serve as a mechanism to achieve broader results, its strategies must encompass the development of effective, competitive enterprises -- and not just the sale of assets.

As such, privatization efforts should provide more than technical assistance before and during the sales process and include assistance to newly privatized firms for gaining access to new technologies, skills upgrading, and management training. These principles can be considered to be corporate governance, which will determine whether or not newly privatized firms will be able to survive in competitive marketplaces.

Corporate governance issues that need to be addressed by donors include technical assistance in developing new management structures and expertise; skills development (such as accounting and marketing); and strategic planning in terms of production, sales and marketing.

**Box IV-A**  
**Technical Assistance**  
**USAID/Costa Rica**

The USAID/Costa Rica Mission provides a useful example of providing limited, post privatization technical assistance.

The Mission is currently assisting a cooperative formed by former employees of 120 retail outlets previously owned by the government. The employees lacked the managerial experience to compete successfully with private sector outlets and requested assistance from the Mission.

With Mission support, the cooperative is using a consulting firm to manage and consolidate its holdings, develop a strategic plan for the next two to five years, and train in-house managers. After this transitional period, management control will return to the Cooperative.

USAID's comparative advantage regarding corporate governance could be to build *local* capacity in this area. Instead of funding management training and business management courses, USAID could fund the strengthening of private sector organizations, such as NGOs, training centers, and cooperatives, that provide these services. In Russia, for example, USAID is setting up an

institutional strengthening and training program for the Bankers Institution. Upon completion of the project, the Bankers Institution will be able to provide training and services to a wide range of smaller banks and financial organizations. Similar mechanisms could be developed to fit other country conditions and meet their development needs.

### ***Financing Mechanisms***

Most developing countries' banking sectors do not have the capacity to work with small scale investors. As such, newly privatized enterprises can create a demand for capital that outstrips many local financial markets' capacities. These groups are frequently denied access to credit that is critical for upgrading facilities, training management, manpower development, and gaining access to new technologies.

Key informants stressed the important role USAID still needs to play in working with the many new small scale businesses that are becoming active as a result of privatization. Although the Enterprise Funds were established by Congress in Eastern Europe to meet these needs, many respondents expressed concern that these Funds have not met real small business demands in these countries.

Recommendations were made by key informants that USAID provide access to funding for smaller loans that are higher risk and require more administration but have potentially higher returns. These lines of credit will provide assistance to the "borderline" entrepreneurs who have a critical need for access to new technologies and capital improvements and play an important role in assisting emerging small businesses.

### ***Contracting Out/Leasing***

Contracting out public enterprises to the private sector was identified by several informants as an untapped opportunity for the Agency. Contracting out is similar to leasing and usually works under an arrangement in which a management company assumes responsibility to manage an enterprise for a fee. The management contractor takes on no financial exposure whereas a lessee pays for the use of the SOE facility and often takes an equity position (or is given the option to purchase shares) in the enterprise.

Contracting out can have several beneficial aspects:

- It is less complicated than divestiture;
- It is usually less visible than outright sale;
- It tends to have fewer employment repercussions than complete privatization; and
- It bypasses the need for sophisticated financial instruments.

Sri Lanka has demonstrated its political willingness to privatize and has taken a creative approach by developing different methods of privatizing. Sri Lanka presents an example of using management contracts with foreign companies to update outmoded equipment and

technologies, change the management structure, and improve productivity to increase profitability and prepare the SOEs for private ownership. Although these contracts have been highly criticized, they have helped ease the transition to a more competitive and market oriented operation and have generated new profits for the enterprises. Criticisms have centered on the fact that despite the successes of these management contract arrangements, there has been no apparent change in the structure or nature of government control and ownership of these SOEs. However, it still has been viewed as an important first step in preparing these companies for privatization in the future.<sup>45</sup>

Contracting out also complements USAID's entrepreneurial development programs since new contracts often go to small, newly formed businesses. These new government contracts can help a small business develop the skills and resources needed to survive in a competitive market economy.

Contracting out opportunities are being explored in advanced developing countries as well as less developed nations. In Africa, some countries have been pursuing opportunities to contract out health care, seed production, and marketing and fertilizer sale and distribution as a means to create more effective service delivery mechanisms; sale of the asset or activity may never be considered.

Contracting out can also be used to help with basic economic infrastructure construction and maintenance, such as roads, bridges, water systems, and irrigation. Contracting out these activities is seen as an opportunity to improve public works at less cost and with fewer management problems.<sup>46</sup>

## CONCLUSION

The previous sections have explored some of the critical issues and findings from USAID's privatization programs. One thing clearly stands out from this discussion: there is no uniform "model" of successful privatization.

The evolution of privatization has developed a variety of approaches that have met country conditions and are far advanced from original concepts. For example, pilot efforts have been made in the use of mass privatization, vouchers and coupons, mass auctions, capital markets development and investment fund formation. These new approaches have revealed

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<sup>45</sup> Sarkar, Rumu. *A Structural Framework for Privatization*. For the Asian-African Legal Consultative Committee in Tokyo, Japan 1994. Washington, D.C.: USAID, 1994. Annex A p. 3.

<sup>46</sup> USAID. *Trends and Benefits of AID's Privatization Program*. Washington, D.C.: USAID, 1990. P. 83.

privatization's flexibility and adaptability to function under difficult local conditions such as weak financial markets, limited local investors, slow growth, and tentative public and private sector support for privatization.

The lessons of experience have provided policymakers with a range of options when developing a privatization strategy. Before initiating any new initiative, several critical questions and concerns should be considered:

- Is a country ready or capable of considering a private sector oriented growth strategy?
- Does privatization advance a country's development priorities?
- Does the political will exist to implement privatization?
- What are the basic limitations or hurdles that privatization will face during implementation and how can these be addressed?

Below are a few suggestions that can help practitioners think through the implementation of these issues:

*Privatization's support to a country's development objectives.* Each of the following scenarios provide a place for privatization to support and fit a country's goals: (1) a country struggling to meet its citizens' basic health care needs could enhance and expand service delivery through privatization; (2) a country that controls its natural resources and crops through parastatals could improve price and crop production through reforming and/or privatizing these areas; (3) a struggling democracy trying to build a civil society could benefit from a stronger private sector voice in policymaking; and (4) a country that would like to increase its international trade (but lacks the appropriate technology) could increase its commercial transactions through greater private sector participation in the economy.

*Developing a sustainable privatization strategy.* Issues for consideration include: (1) considering support for developing and strengthening business groups and associations that can advocate and advance their demands; (2) ensuring the proper resources are given to develop environmental rules and regulatory institutions that can regulate private sector growth; and (3) assessing and addressing the management training, technology, and credit requirements for newly privatized firms.

*Potential stumbling blocks to privatization.* Some of the following themes should be considered before privatization commences: (1) addressing public and labor union resistance to privatization through educational awareness, retraining programs, and employment packages; (2) dealing with a weak macroeconomic environment through policy reform; (3) assessing local institutional capacity and public sector skills,

developing the necessary programs to address these needs, such as training programs for government workers and resources for new regulatory bodies; and (4) developing the necessary legal framework that can support and regulate private sector growth.

*Appropriate first steps before initiating privatization.* Several key issues should be dealt with before privatization takes place: (1) ensure that all stakeholders are involved in the privatization strategy process; (2) develop a set of objectives that are clear, realistic, and well supported by the government, community leaders, the public, and donors; (3) encourage the government to establish an autonomous, centralized body that has the authority to effectively implement a privatization endeavor.

*Other donors working in privatization.* Consideration should be given to: (1) if the World Bank is an active player in a country's privatization endeavors, what role are they taking; (2) how can USAID best use its resources to supplement and complement what other donors are already doing in privatization; and (3) what steps can be taken to ensure donor collaboration and coordination throughout the design and implementation strategies.

In future planning efforts, privatization should be viewed by technicians and decision makers as one approach or tool that can support broader, programmatic goals. USAID will probably not undertake many large-scale privatization initiatives in the late 1990s -- the exception may be its Eastern Europe and Russian portfolios. What is more likely to emerge is a mix of approaches, ranging from smaller privatization schemes to improve the delivery of health care services to larger programs that emphasize economic and institutional restructuring.

Sometimes privatization will be a critical element to a development strategy that may include strengthening civil societies or lowering the delivery cost of public services. In other country settings, privatization may not be appropriate to achieve the economic or social priorities of the host country. In either case, this tool is a useful device to consider and implement in a variety of settings.

This paper has attempted to bring new insight to privatization's integration into USAID's strategic priorities in health and family planning, the environment and natural resources, and democracy and governance. Privatization should be viewed, not as an objective, but as a tool that has the capacity to support broader development goals.

## ANNEX A

### THE IMPACT OF THE HONDURAS PRIVATIZATION PROGRAM

#### *The Honduran Privatization Program*

In 1986 USAID launched its privatization assistance to the government of Honduras under the Privatization of State-Owned Enterprises project. The project originated in response to the concern of a large number of Hondurans in the private and public sectors that most of the SOEs created in the mid-1970s had failed to contribute to the country's development and had become a serious fiscal drain.

Today, the Honduran government points to its privatization efforts with enthusiasm. The Honduras Mission has reported that from a universe of 70 SOEs, with an estimated market value of over \$700 million, the GOH has privatized 41 enterprises worth over \$157.5 million.

#### *Impact*

The USAID Mission in Honduras stipulates that the benefits accrued from the privatization of these 41 entities include:

- The creation of over 2,000 new permanent jobs;
- An estimated creation of 5,000 indirect jobs;
- a \$29 million reduction in the government's external debt;
- The generation of over \$18 million in new investment for current plants and new equipment; and
- The generation of over \$15 million in annual exports.

These conclusions are supported by an evaluation conducted in 1991 of the USAID/Honduras project, concluding that:

The economic benefits of privatization are clear and significant. The project has resulted in a creation of jobs, reductions in the fiscal deficit, increases in export and foreign exchange earnings and improvements in the balance of trade.<sup>47</sup>

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<sup>47</sup> USAID. *Evaluation of Project 522-0289, Privatization of State-Owned Enterprises in Honduras*. Carana Corporation. Washington, D.C.: USAID, 1991. p. iv.

This same evaluation went on to note that the use of local currency to underwrite severance pay to displaced workers has proven to be an "essential" ingredient for the project's success. These resources have lent invaluable support to achieving the project's objectives.

The support of the Callejas Administration has been seen as key to privatization's advancement in Honduras. Prior to this Administration, only 11 small enterprises had been privatized. During President Callejas's term of office a total of 30 SOEs worth \$126.8 million have been privatized. In addition, the Ministry of Communications and Transportation has privatized the maintenance of rural roads and sold 50 units of heavy equipment.

### ***Lessons Learned***

Lessons learned from the Honduras privatization experience include:

- Clear and determined presidential leadership is essential for a privatization project to succeed. This needs to be manifested in the establishment of a strong central mechanism, invested with the appropriate binding authority, to coordinate the process and insure all institutional actions fulfill their respective mandates.
- Setting realistic goals and expectations is essential to the performance and impact of privatization projects.
- Political institutions maybe the most important determinant for the success or failure of privatization.
- Privatization should be considered one of several means toward economic growth and development -- not an end in itself.
- The role played by severance payments is key. This effectively blunts criticism from organized labor and cushions the impact of lay-offs.
- Not all SOEs can or necessarily should be privatized.
- The privatization process needs to be transparent -- but must also have appropriate checks and balances to ensure integrity and credibility.<sup>48</sup>

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<sup>48</sup> USAID. *Evaluation of Project 522-0282: Privatization of State-Owned Enterprises in Honduras*. CARANA Corp. Washington, D.C.: USAID, 1991. p. 34.

### ***Current Events***

**A Project Amendment signed in June of 1993 has extended USAID's technical assistance to the Honduran government privatization efforts through December 1995.**

**The Mission is currently providing technical assistance to the government to privatize the national telephone company -- HONDUTEL. By the end of February 1994, the government is also expected to close the sale of its duty free zone.**



## **ANNEX B**

### **KEY INFORMANTS INTERVIEWED**

#### ***USAID Officials***

**John Balis, Asia/NE Bureau**

**Richard Burns, Europe Bureau**

**Kim Delaney, USAID/Guatemala**

**James Dempsy, Asia/NE Bureau**

**David Dodd, Europe Bureau**

**Penny Farley, Office of Emerging Markets**

**Thelma Furlong, Europe Bureau**

**David Jessee, USAID/Cairo**

**Peter Kranstover, USAID/Costa Rica**

**Monica McKnight, Office of Emerging Markets**

**Dennis McGower, Europe Bureau**

**Deborah Prindle, Europe Bureau**

**Private Sector Officer, USAID/Honduras**

**Richard Rosenberg, USAID/Bolivia**

**Don Smith, RDO/Caribbean**

**Ronald Stryker, LAC Bureau**

**John Tomaro, R&D/Health**

**H. Abdul Wahab, USAID/Haiti**

**Key Informants, con't**

Michael Unger, Africa Bureau

Gary Vaughn, Asia/NE Bureau

James Vermillion, Asia/NE Bureau

***World Bank Officials***

Stuart Bell, PSD, World Bank

Paul Hinchey, IFC/World Bank

Russell Muir, PSD, World Bank

Hafez Shaik, CFC, World Bank

Mary Shirley, Finance & PS Division, World Bank

***Contractors***

Betsy Bassan, Director of Africa and Asia  
Chemonics

Steve Benford, Privatization Specialist  
Chemonics

Robin Davis, KPMG Peat Marwick

Paul Elicker, Privatization Expert  
CFED

Mark Hoffman, Director of IPG  
Price Waterhouse

Ronald Ivey, Privatization Manager  
Deloitte & Touche

Roger Leads, Privatization Expert  
KPGM Peat Marwick

## **Key Informants, con't**

**Theodore Panayotou, Environmental Specialist  
Harvard Institute for International Development**

**Peter Raymond, Privatization Specialist  
Chemonics**

**Bob Rourke, Director of Privatization  
Coopers and Lybrand**

**Jeff Scharz, Russian Country Officer  
Price Waterhouse**

**John Strattner, Director of Privatization  
Chemonics**

**James Waddell, Director of Privatization  
Price Waterhouse**

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